this proceeding to assess the tenuous state of competition in the special access market. *Because competitive forces are inadequate to constrain the ILECs' monopoly behavior,* the Commission should rescind Phase II pricing flexibility and impose reasonable regulated rates.

D. Despite Above-Cost Rates in MSAs Where ILECs Have Been Granted Phase II Pricing Flexibility, Widespread Competitive Entry Has Not Occurred and Few Competitive Alternatives Exist to Discipline Special Access Rates to a Competitive Level.

A key reason that the ILECs are able to sustain supra-competitive rates for special access is because of the lack of facilities-based competitive alternatives. As explained in the attached Declaration of Ajay Govil, XO's Director of Transport Technology and Network Architecture, there are multiple reasons for this scarcity. First, it remains inefficient for most CLECs to build high-capacity loop facilities themselves.[57] Second, interconnecting with the few competitive access providers ("CAPs") that do exist provides little in the way of economic benefit.[58] Finally, no other technology has yet developed as a widely available wireline loop substitute.[59]

Except in rare instances, it is uneconomic for CLECs to build their own high-capacity facilities to their customers. For a CLEC to provide its own facilities, the demand must be so great that it overcomes the large, sunk cost incurred in provisioning service directly to the customer. **BEGIN CONFIDENTIAL**

57 XO *Govil Decl.*, ¶ 12-21.

58 *Id.*, ¶ 29.

59 *Id.*, ¶ *25*

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CONFIDENTIAL To justify this level of expense, a CLEC must have the equivalent of at least three DS-3s worth of capacity under contract from the occupants of such a building.[61] Any less and the CLEC must find another way to provision service or risk taking a major loss on its investment.

Only the very largest customers need three DS-3s worth of capacity. Most customers, including most small- and medium-sized businesses, will function perfectly well with DS-1 level access or metro Ethernet-level access which increasingly fills the gap between DS1 and DS3 TDM-based services. The Commission's *TRO* finding that CLECs "face extremely high economic and operational barriers" in deploying DS1 loops remains true today.[62] The Commission also recognized that small- and medium-sized business customers who use DS-1 level access present significantly different characteristics from large enterprise customers, and that such smaller customers are generally resistant to the type of long-term contract that would justify building out facilities to the customer's location.[63]

The lack of competitive access providers offering economical services also directly increases CLEC reliance on ILEC special access.[64] For the reasons discussed above, very few competitive access providers can offer on-net ("Type I") end-to-end service. On the rare occasion when Type I services are offered, such services are

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60 *Id.*, ¶ 17.

61 *Id.* ¶ 10, 20.

62 TRO ¶ 325.

63 *Id.*

64 XO *Govil Decl.* ¶ 28.

generally priced significantly less than ILEC special access and can be a very attractive option for CLECs.[65]

Unfortunately, the vast majority of competitive access providers must make use of ILEC special access services or ILEC UNEs themselves to provide wholesale service reaching to the end user's location ("Type II" services). CLECs generally do not favor purchasing Type II facilities because the underlying provider does not control the entire facility. In addition, while purchasing Type II services from a competitive access provider may provide some cost savings, such savings are generally not significant because Type II service providers must pass on the price they paid to the ILEC for special access plus its own markup.[66] Finally, as a result of the *TRRO*, many UNEs have been eliminated and converted to significantly higher, non-cost-based priced special access. This has caused prices to rise for all CAPs, including those providing Type II services. As a result, many Type II services are now generally equivalent to, if not above, the price for ILEC special access.

For these reasons, CLECs like Covad, NuVox, and XO make very little use of CAP provided loops. Currently, less than **BEGIN CONFIDENTIAL END CONFIDENTIAL** of Covad's and NuVox's loop access needs are met by using competitive alternatives to ILEC special access.[67] XO also currently uses alternative loop access providers for only a small part of its needs.[68]

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65 XO *Govil Decl.* ¶ 28; NuVox *Coker Decl.* ¶ 5.

66 *Clancy Decl.* ¶ 6.

67 Covad *Clancy Decl.* ¶ 7; NuVox *Coker Decl.* ¶ 5.

68 XO *Govil Decl.* ¶ 28-29.

The failure of intermodal platforms to develop into widely available substitutes for ILEC special access, even with special access priced so far above cost, has also helped the ILECs maintain their stranglehold on last-mile service.[69] Although fixed wireless services are starting to be deployed successfully, there is nothing close to ubiquitous coverage and obstacles, presented by the ILECs, have limited deployment. For the past year, XO has been seeking to obtain collocation for microwave facilities at buildings owned by AT&T where XO and others are collocated; yet, AT&T has thwarted XO at every turn, such that, over one year since it began seeking to collocate its facilities, none have been deployed.

Cable television systems also have not developed in a manner that allows them to serve as alternatives for widespread deployment of DS-1 or DS-3 loop facilities. Most cable televisions systems were designed to serve residential customers in suburban areas. Thus, commonly the cable television systems do not reach the customers to whom the CLECs need to connect.[70] Where cable television networks reach business customers, they generally lack the capacity to serve large numbers of business customers that require telecommunications and Internet services at DS1 and higher speeds. While some cable networks have been developed to provide high bursts of speeds to smaller customers, few cable systems are capable of meeting the high bandwidth requirements of larger customers like those serviced by XO, Covad and NuVox.[71]

69 Because customers for special access services demand reliability, high quality, and high speed, many of the frequently mentioned alternatives, such as satellite, broadband powerline, or mobile wireless services, are very poor substitutes.

70 XO *Govil* ¶ 22-24.

71 XO *Govil* ¶ 24.

E. The Terms and Conditions of ILEC Price-Flexibility Tariffs and Contracts Are Onerous and Exclusionary

The Commission also has recognized that market power can be exercised through exclusionary conduct as evidenced by onerous terms and conditions in a LEC's tariff offerings.[72] Because special access services are characterized by economies of scale and significant sunk costs, with impediments such as rights-of-way and building access, market entry by competitive providers has been limited and generally concentrated in the highest capacity services in the densest metropolitan areas.[73] Additional barriers to entry other than these economic and operational impediments may be imposed unreasonably by the ILECs to prevent competition in both the wholesale and retail markets for these services. As the Commission's former chief economist explained:

> Among such incremental impediments to entry would be (a) excessive charges (typically payable by the customer) for terminating ILEC service, (b) commitments to purchase some minimum amount from the incumbent, with substantial penalties for non-compliance, and (c) any provisions such as volume or loyalty discounts under which a special access consumer pays the ILEC more for something else (such as service at another location) if it uses an entrant rather than ILEC special access in one location.[74]

Although such contracts may not have exclusionary effects in a competitive environment, exclusionary or anti-competitive conduct often arises when an incumbent with market power is the only entity that can supply each customer's entire demand.[75] As discussed

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72 *Special Access NPRM* ¶ 114.

73 *Farrell Decl.* at 2.

74 *Farrell Decl.* at 2.

75 *AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM-10593, *Reply Comments of WorldCom, Inc., Declaration of Michael D. Pelcovits On Behalf of WorldCom Inc*, at 8 n.6 (filed January 23, 2003) ("*Farrell Decl.*").

above, the ILECs have the market power to succeed with anti-competitive behavior and have strong incentives to use exclusionary pricing to prevent entry and expansion of the competitors.[76] As explained in declarations already on the record, especially by Drs. Pelcovits and Farrell, such practices were widespread years ago when the Commission initiated this proceeding. These practices continue to plague competitors in the industry today.

To avoid paying the most excessive of the special access rates discussed above (*i.e.*, the month-to-month rates), special access customers have little choice but to enter into contractual arrangements with the ILECs where they obtain discounts off month-to-month special access rates in exchange for committing to unreasonable purchase volumes or term periods. The RBOCs claim that most of their customers purchase from contracts providing significant discounts off of their month-to-month special access rates. Many of those contracts, however, contain onerous conditions that few customers are able to meet or that lock-in customers unreasonably foreclosing other supply options. For example, Verizon recently offered a National Discount Plan ("NDP") created for and targeted primarily to a single very large carrier with volume commitments much higher than any CLEC could achieve to gain the discounts.[77] Additionally, many of the volume discounts include growth components requiring carriers to increase their volume commitments annually. Often, the required growth rates are higher than a carrier's historical trend. This indicates that the required growth rates are too high for that competitor to realistically achieve without incurring penalties. Thus, many competitors are left with

76 *Farrell Decl.* at 9.

77 The Verizon Telephone Companies, TARIFF F.C.C. No. 1, Original Pages 25-40 Section 25.3 (effective June 9, 2007).

little choice other than to purchase from the highest base month-to-month special access rates.

Additionally, AT&T's special access tariff offerings and discount plans are administered at the regional level based on AT&T's legacy companies (Pacific Telesis Group, Ameritech, Southwestern Bell, BellSouth, and SNET) and do not allow volume commitments to be met with services throughout the entire consolidated AT&T region. AT&T also does not easily allow portability, or the substitution of one circuit for another to meet volume commitments, throughout all of its legacy sub-regions, so competitors may be subject to early termination penalties in some areas if a circuit is disconnected before the end of the committed term.[78] Because these terms are managed at the legacy regional level rather than throughout the incumbent's entire service territory, competitors cannot combine their purchases throughout the region to satisfy the cumbersome minimum requirements. Unlike AT&T, who can offer a retail customer a comprehensive rate plan that would span its vast nationwide service territory, a competitor's ability to manage its own large national customers is more limited because it must adjust and account for various differing rate plans and requirements.

Moreover, while the RBOCs argue that term commitments ensure they are able to recoup their necessary costs, term commitments with onerous termination penalties when imposed by firms with market power have anti-competitive effects. For example, Verizon's Commitment Discount Plan ("CDP") requires a minimum two-year term to qualify for discounts. Additionally, Qwest's month-to-month special access rates are so excessive that carriers are induced to commit to a one-year term to gain more reasonable rates. The termination penalties for most of these ILEC discount plans are unreasonable

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78 Covad *Clancy Decl.* ¶ 13; XO *Govil Decl.* ¶ 34.

because the customer must pay some of the remaining months at the full monthly rate even if the circuit is disconnected well before the end of the first year. For example, under Qwest's *Regional Commitment Plan ("RCP"), if a customer terminates service* within the first 12 months of any of its term plans, the customer will incur an early termination penalty of 100% of its contracted monthly charges for the remaining months of the first year.[79] The customer would additionally pay 50% of its committed monthly charges for the remaining months of the contract.[80] A customer is also subject to a shortfall if its actual volume of circuits falls below its committed monthly volume. In this case, the customer is charged a shortfall based on the average circuit price multiplied by the difference between its actual circuits in service and its committed volume.[81] Therefore, for example, a competitor utilizing an ILEC's special access services to provide retail services to its customer must require that customer to commit to a minimum term or risk being subject to an extreme termination penalty. This leaves competitors at a significant disadvantage in the retail market because Verizon need not require its own retail customers to commit to a two-year minimum term.

The RBOCs have justified their excessive termination penalties as a way of preventing customers from obtaining discounts in the short term and then canceling service when they no longer meet the volume requirements.[82] A termination penalty

79 Attachment 3, Qwest Communications, TARIFF F.C.C. NO. 1, 3rd Revised Page 7-154, Section 7.1.8(B) (Effective December 16, 2003).

80 Attachment 3, Qwest Communications, TARIFF F.C.C. NO. 1, 2nd Revised Page 7-106, Section 7.1.3(B)(5) (Effective February 1, 2006).

81 Attachment 3, Qwest Communications, TARIFF F.C.C. NO. 1, 3rd Revised Page 7-104, Section 7.1.3(B)(3)(c) (Effective February 1, 2006).

82 *Opposition of Qwest Communications , Declaration of Alfred E. Kahn and William E. Taylor On Behalf of BellSouth Corporation, Qwest Corporation, SBC Communications, Inc., and Verizon,* at 32 (filed December 2, 2002) ("Kahn & Taylor Declaration").

imposed by a firm with market power which requires payment of the full amount (or a large percentage) of the contract through the entire term of the contract even after it has terminated service, however, is punitive in nature, and is not based on cost recovery. Since even the discounted special access rates greatly exceed cost-based rates for comparable UNEs, such a penalty implies the RBOCs have more nefarious purposes: to drive up the wholesale costs of its competitors and to lock-in its customers so they are unable purchase circuits from a competitor.[83] Because of the short supply of competitive alternatives for special access circuits, neither wholesale nor retail customers have the option of selecting another provider of special access that may not impose such termination penalties; therefore, the RBOCs are able to use their market power to impose these onerous conditions on their customers, which also operate to exclude their competitors from the market.

Even without the excessive volume and term commitments, ILEC special access contracts contain anti-competitive provisions. For example, several AT&T contracts require that at least 4% of services ordered must be switched over from a non-incumbent provider.[84] This anti-competitive requirement is included solely to draw business away from AT&T's competitors and must be prohibited. By tying up customers and requiring business to be moved from its competitors, AT&T is able to further strengthen its significant power in the market.

Additionally, AT&T has adopted pricing plans that undermine a competitor's ability to offer discounts to customers for a particular service because the competitor

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83 *See Pelcovits Decl.* at 5; *Farrell Decl.* at 2.

84 *GAO Report* at 31, Table 4 (*citing*, Southwestern Bell Contract No. 15, Ameritech & Pacific Bell Contract No. 20, and Southern New England Telephone Contract No. 1.

would lose discounts it had obtained from AT&T on other services.[85] For example, in order to obtain discounts under AT&T's Managed Value Plan for both for its legacy Ameritech and Southwestern Bell regions ("MVP"), competitors must not only commit to minimum annual revenue requirements ("MARCs") of $10 million in each region, but they must also maintain an Access Service Ratio of 95% or greater, meaning that no more than 5% of a competitor's monthly billing with AT&T may be for UNEs, including DS1 and DS3 UNE loops, and DS1, DS3 and dark fiber UNE transport.[86]

Volume and growth requirements, coupled with termination penalties, of AT&T's MVP impede a competitor's ability to win or retain a customer who may already be on this plan with AT&T. The retail customer receives a discount only on amounts up to the MARC but not over the MARC, creating an incentive for customers to increase the MARC as its needs grow in order to receive the discount on its growth rather than paying the base special access rates. Although the MARC may be increased, it may not be decreased during the term of the plan. Because the MARC is based on 100% of historical revenues and because it cannot be decreased, a customer whose demand does not grow cannot switch to a competitive carrier for part or all of its special access spending without incurring significant penalties.[87] Customers who fail to meet the MARC either incur a shortfall penalty or an excessive termination penalty, including repayment of the past six

85 *Pelcovits Decl.* at 15.

86 Ameritech Operating Companies,TARIFF F.C.C. NO. 2, 3rd Revised Page 663 & 5th Revised page 664, Section 19.3(D) (Effective June 8, 2002), Southwestern Bell Telephone Company TARIFF F.C.C. NO. 73, 3rd Revised Page 38-6 & 3rd Revised Page 38-7, Section 38.3(D) (Effective June 8, 2002).

87 *Farrell Decl.* at 5-6.

months' discounts, if the contract is cancelled.[88] AT&T's MVP tariff fits the pattern of an exclusionary contract by tying the offered discounts to maintaining traffic on AT&T's network, and creates a very large hurdle for competitors to overcome.[89] "These provisions, and others like them in the various term and volume discount plans offered by the ILECs, artificially increase a customer's cost of switching, and raise competitors' costs of acquiring customers.

Verizon also has offered a promotion in connection with its UNE forbearance petitions that required competitors' high-capacity UNEs to be converted to special access in order to qualify for lower special access pricing.[90] For companies that rely extensively on UNEs, some of which have a current ratio of special access to UNEs of less than 10%, this requirement is obviously unreasonable because there is no way for these carriers to take advantage of special access discounts without converting most of their circuits from UNEs to higher priced special access. This requirement is anti-competitive because it requires competitors to forego their rights to purchase UNEs at lower cost-based rates and instead to rely almost entirely on higher-priced and virtually unregulated special access. Moreover, there is no cost justification for this requirement. The only reason for it is to drive up the ILEC's competitors' costs.

Extensive long-term commitments and growth requirements imposed by a firm with market power discourage and prevent competitors from seeking out competitive alternatives or self-provisioning once they are locked into an ILEC special access term

88 Ameritech Operating Companies, TARIFF F.C.C. NO. 2, 3rd Revised Page 677 & 2nd Revised Page 678, Section 19.3(J)(Effective April 10, 2002); Southwestern Bell Telephone Company TARIFF F.C.C. NO. 73, 2nd Revised Page 38-21 & 2nd Revised Page 38-21.1. *See also*, *Farrell Decl.* at 3-4; *Pelcovits Decl.* at 14.

89 *Pelcovits Decl.* at 14-15.

90 Covad *Clancy Decl.* ¶ 12.

commitment.[91] After committing to 3-year or 5-year terms, competitors are prevented during that time from converting their high-priced ILEC special access services to lower-cost alternatives from other vendors or via self provisioning without incurring significant termination penalties. By targeting the growth market where competition or entry would be most likely, the ILECs can prevent the development of a more facilities-based competition.[92]

Even a one-year term commitment in the hands of the RBOCs may be anti-competitive. In a situation where no UNE facilities are readily available, a competitor may provide service temporarily via special access services with the intention of converting that customer to UNE-provided services shortly after provisioning. The competitor must continue purchasing special access circuits even though a lower-priced UNE alternative has become available. With even a one-year minimum term for special access services, the ILEC is able to intentionally lock its competitors into utilizing special access longer than they would otherwise do so, significantly and artificially increasing the competitors' costs.

Joint Commenters certainly do not wish to undermine the ILECs' ability to offer discounts off of their base special access rates. ILEC special access discounts, however, should come without such anti-competitive strings attached since customers have no alternatives for a large share of their business.[93] Exclusionary pricing, in contrast to predatory pricing, can be virtually costless because it does not require the offending entity to ever set price below its own costs, thereby eliminating the need to later recoup

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91 *Pelcovits Decl.* at 13.

92 *Id.*

93 *Id.* at 16.

those costs.[94] By inducing enough buyers to sign long-term, high volume or growth contracts, the ILEC can tie up enough customers and volume such that there is insufficient demand available for competitors to enter the market and operate profitably.[95]

More generally, the ILECs also continue to attempt to constrain competitors' abilities and rights to challenge the excessive special access rates and charges imposed upon them. When additional charges, such as those for special construction, are required they are often are not adequately explained or detailed. Some ILEC discount plans restrict a competitor's ability to dispute charges or prevent any disputed charges to count toward minimum commitments even if the competitor later pays the charges.[96] Other plans attempt to restrict competitors' rights to seek regulatory recourse by forbidding them from participating in regulatory proceedings that condemn the ILEC's excessive special access rates.

In the special access market, both supply responsiveness and demand responsiveness are low, allowing the LECs to hold onto market power and exercise it at will. Supply responsiveness measures whether competitors enter the market with enough capacity to supply competing services when a LEC increases rates for special access. Demand responsiveness measures whether consumers have the ability to make a switch to a competitor if such an alternative exists. As discussed above, there are very few special access competitors remaining in the market, and none that have the capacity to satisfy demand throughout the market. Furthermore, the exclusionary pricing plans employed by the LECs lock-in customers so they are often unable to switch to an

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94 *Id.* at 5-6.

95 *Id.* at 5-9.

96 XO *Koppersmith Decl.* ¶ 6.

alternative carrier, even if one exists. Thus, because drastically above-cost ILEC rates have not induced competitive entry and the largest competitors in the market have exited due to mergers with the ILECs, there is not nearly enough competition to discipline the rates, terms and conditions of ILEC special access services.

IV. RECENT REGULATORY DEVELOPMENTS DRIVE DEMAND FOR INCUMBENT LEC SPECIAL ACCESS, IRRESPECTIVE OF COSTS

Since the initial filing of comments and reply comments in this proceeding, changes within the industry have stalled competition within the market for special access services, and at the same time, have eliminated loop and dedicated transport facilities and services that CLECs tend to use as special access service substitutes. In only two years, the industry witnessed the simultaneous mergers of dominant special access service providers, Verizon and SBC, each with their biggest in-region competitor, MCI and AT&T. Subsequently, the new "AT&T" swallowed BellSouth, thereby narrowing competition within the market for special access services within nine additional states. Importantly, as the selection of special access service providers has become smaller, so has the selection of substitute services. In particular, the Commission's most recent rule changes, limiting the high-capacity loop and dedicated transport UNEs available to competitors, have only increased the ILEC's market power for special access services.

A. Recent Mergers Have Eliminated the Two Largest Competitive Providers of Special Access Services

Since the initial filing of comments in this proceeding, the Commission has approved three RBOC mergers, resulting in substantial, industry-wide impact. In November 2005, the Commission approved the mergers of Verizon and MCI, and of SBC and AT&T.[97] In December 2006, the Commission approved the acquisition of BellSouth by the "new" (*i.e.*, post SBC-merger) AT&T.[98] As the result of these mergers, the telecommunications industry is, and special access markets are now, dominated by two giants, each of which provide service within more than 20 states.[99]

Among other things, those mergers reduced both actual and potential competition among providers of special access services within each of the former operating territories of BellSouth, SBC, and Verizon, leaving customers to rely primarily on the special access services offered by the two RBOCs.[100] Because little or no competition exists within the markets for various special access services, the ILECs now, more than ever, have broad discretion to increase rates for special access services far above cost, and to condition discount service arrangements on terms that harm customers and discriminate against

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97 *SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, WC Docket No. 05-65, Memorandum Opinion and Order, FCC 05-183 (rel. Nov. 17, 2005) ("SBC/AT&T Merger Order"); *Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, WC Docket No. 05-75, Memorandum Opinion and Order, FCC 05-184 (rel. Nov. 17, 2005) ("Verizon/MCI Merger Order").

98 *In the Matter of AT&T Inc. and BellSouth Corporation Application for Transfer of Control*, Memorandum Opinion and Order, 22 FCC Rcd 5662 (2007) ("AT&T/BellSouth Merger Order").

99 The Form 10-K of Verizon Communications Inc. (Part I, Item I) filed with the United States Securities and Exchange Commission on March 7, 2007 reflects that Verizon provides wireline telephone services to customers within 28 states, and the District of Columbia. The Form 10-K of AT&T Inc. (Part I, Item I) filed with the United States Securities and Exchange Commission on February 26, 2007 reflects that AT&T's "traditional wireline subsidiaries " provided long distance and local telephone services within 13 states, as of December 31, 2006. After acquiring BellSouth's operating subsidiaries, on January 1, 2007, AT&T provides wireline telephone services within 21 states.

100 Comments of Cbeyond *et al.*, WC Docket No. 06-74, at 63-74 (filed Jun. 5, 2006); Petition to Deny of CompTel, WC Docket No. 06-74, at 7-8 (filed Jun. 5, 2006); Comments of Sprint Nextel Corporation, WC Docket No. 06-74, at 11-12 (filed Jun. 5, 2006); Petition to Deny of Time Warner Telecom, WC Docket No. 06-74, at 16-25 (filed Jun. 5, 2006).

competing providers.[101] The conditions ordered by the Commission for each individual merger provide only short-term and ultimately inadequate protections against the RBOCs' demonstrated exclusionary and discriminatory inclinations and practices, and are simply insufficient to ensure that robust competition in the market for special access services will develop and be sustained.

Notably, the RBOC mergers of the past two years each were approved by the Commission notwithstanding record evidence that: (1) the mergers would eliminate the most significant source of actual and potential competition for special access services within each of the RBOC and affiliated ILEC operating territories;[102] (2) high barriers to entering the market for special access services would foreclose future competition;[103] and (3) RBOC consolidation in the markets for special access services would provide the

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101 Comments of Cbeyond *et al.*, WC Docket No. 06-74, at 88-90 (filed Jun. 5, 2006); Petition to Deny of CompTel, WC Docket No. 06-74, at 11-12 (filed Jun. 5, 2006); Petition to Deny of Earthlink, Inc., WC Docket No. 06-74, at 21-27 (filed Jun. 5, 2006); Comments of Sprint Nextel Corporation, WC Docket No. 06-74, at 6-9 (filed Jun. 5, 2006); Petition to Deny of Time Warner Telecom, WC Docket No. 06-74, at 32-49 (filed Jun. 5, 2006).

102 A report submitted by XO Communications in the Verizon/MCI and SBC/AT&T merger proceedings before the Commission shows that MCI's market share of 10% of Wholesale Metro Private Lines, over all metropolitan areas, ranked first outside of the RBOCs. Following the merger of Verizon and MCI, the market share of Wholesale Metro Private Lines owned by Verizon increased from 74% to 84%. The same study reflects that AT&T's market share of 9% of Wholesale Metro Private Lines, over all metropolitan areas, ranked second outside of the RBOCs. Following the merger of AT&T and SBC, the market share of Wholesale Metro Private Lines owned by the "new" AT&T increased from 75% to 84%. *Ex Parte* Letter from Thomas W. Cohen, Kelley Drye & Warren, LLP, Counsel for XO Communications to Marlene H. Dortch, Secretary, Federal Communications Commission, WC Docket Nos. 05-65 and 05-75 (filed Sept. 21, 2005) (enclosing Wholesale Communications Strategies, The Yankee Group, Prepared for XO Communications, January 2004); *see also supra* n.100.

103 Comments of Cbeyond *et al.*, WC Docket No. 06-74, at 62 (filed Jun. 5, 2006); Petition to Deny of CompTel, WC Docket No. 06-74, at 11-12 (filed Jun. 5, 2006); Petition to Deny of Time Warner Telecom, WC Docket No. 06-74, at 10-16 (filed Jun. 5, 2006).

RBOCs with increased opportunities and incentives to raise special access rates farther above cost, and to engage in practices that would harm special access competition.[104] The remedies adopted by the Commission are not sufficient to redress the adverse impact of those mergers on the offering of special access services. As demonstrated by the evidence provided herein, they already have proven, to a significant degree ineffective.[105] The Commission therefore should recognize their limited value and adopt regulations that discipline special access rates in the absence of real competition, and permit competition to thrive.[106]

As an indication of the weakness of the merger condition limiting special access price increases, record evidence before the United States Court for the District of Columbia, in the Tunney Act review proceeding demonstrates that, as the result of those mergers, unreasonable price increases for special access services occurred.[107]

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104 *See supra* n. 101.

105 *See infra* n.107. The record before the United States District Court for the District of Columbia, in the Tunney Act proceeding on the mergers of Verizon and MCI, and AT&T and SBC, is replete with evidence that the RBOCs' pricing of special access services increased post-merger.

106 Another flaw with the conditions imposed by the Commission in the RBOC mergers is that they are in effect only for the short term. Specifically, those conditions will expire after thirty (30) months, in the case of Verizon, or after forty-eight (48) months, in the case of AT&T, without any further review by the Commission. Verizon/MCI Merger Order, Appendix G; AT&T/BellSouth Merger Order, Appendix F. The Commission, *sua sponte*, even reduced the duration of Special Access Condition No. 6, setting caps for the prices, terms and conditions at which AT&T may offer DS1 and DS3 channel termination services, from forty-eight (48) months to thirty-nine (39) months, after approving the merger of AT&T and BellSouth. *In the Matter of AT&T Inc. and BellSouth Corporation Application for Transfer of Control*, WC Docket No. 06-74, Order on Reconsideration, FCC 07-44, 22 FCC Rcd 6285 (rel. Mar. 26, 2007).

107 *U.S. v. SBC Communications, Inc. and AT&T Corp.*, Civil Action No. 1:05CV02102 (EGS); *U.S. v. Verizon Communications, Inc. and MCI, Inc.*, Civil Action No. 1:05CV02103 (EGS) (consolidated), ActTel's Reply Memorandum in Opposition to

Specifically, by eliminating key lower-priced providers of competing special access services (AT&T and MCI), downward pressure on the pricing of special access services by SBC and Verizon, pre-merger, was relieved,[108] and pricing that was showing signs of decline "stabilized."[109] Moreover, the acquiring companies (Verizon and the "new" AT&T), having been freed from competition, implemented direct increases to DS1 and DS3 private line services not within the jurisdiction of the Commission (*i.e.*, intrastate special access services).[110]

Importantly, the conditions imposed on mergers of Verizon and MCI, and of SBC and AT&T, also are limited in scope to the pricing levels of the merged entities and do not prohibit other practices that may undermine or otherwise defeat competition within the markets for special access services.[111] Despite several *ex parte* submissions by Qwest,[112] the Commission elected to ignore substantial evidence of anti-competitive

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the United States' Motion for Entry of Final Judgments (filed Jun. 6, 2006) ("ActTel Merger Brief") at 15-19.

108 *Id.* In the Tunney Act proceeding, ActTel submitted substantial evidence, including pre-merger statements by Verizon and SBC, demonstrating that competition within the market for special access services was declining before the mergers of 2005.

109 ActTel Merger Brief at 15-17.

110 *Id.* at 17-18, n. 21 (and associated Exhibit). In that proceeding, ActTel demonstrated that AT&T announced price increases for DS1 and DS3 Local Private Lines in seven states within one year of merging with SBC.

111 *See* SBC/AT&T Merger Order at Appendix F; Verizon/MCI Merger Order at Appendix G.

112 *See, e.g.*, *Ex Parte* Letter from Melissa E. Newman, Vice President – Federal Regulatory, Qwest to Marlene H. Dortch, Secretary, Federal Communications Commission Re: WC Docket No. 05-65 (Oct. 5, 2005); *Ex Parte* Letter from Melissa E. Newman, Vice President – Federal Regulatory, Qwest to Marlene H. Dortch, Secretary, Federal Communications Commission Re: WC Docket No. 05-65 (Sept. 27, 2005).

practices by SBC, even prior to consummating its proposed merger with legacy *AT&T.*[113] For example, in re-negotiating its contract-based special access service arrangements, SBC attempted to impose on its existing customers, including Qwest, terms and conditions of service that effectively would prohibit any migration to special access services offered by SBC's competitors, or to other SBC services, including UNEs.[114] In particular, SBC's "take-it-or-leave-it" special access service offering included, for the first time: (1) stringent limitations on grooming of special access facilities, either to move from SBC's special access services to competing special access services, or other, more cost-effective SBC services; and (2) limitations on Qwest's use of UNEs, to five percent of Qwest's total local access spend with SBC.[115] Such provisions that perpetuate carriers' reliance on the ILECs' special access services through limitations on the use of UNEs are anti-competitive and discriminatory.[116]

In addition, commenters in the AT&T/BellSouth merger proceeding advised the Commission that high-volume commitments and associated penalties for early termination of service contracts, place significant limitations on the use of non-ILEC special access services, where those services are available.[117] For example, as CompTel explained, "because only the incumbent can supply *all* of any customer's special access

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113 SBC/AT&T Merger Order, Appendix G.

114 *See supra* n.86.

115 Qwest's October 5, 2005 Ex Parte Letter at 3-5.

116 The ILECs have imposed similar limitations on tariffed special access services. *See, e.g.*, Ameritech Operating Companies, FCC Tariff No. 2, Access Service, 7th Revised Page 659, Section 19 (Effective Oct. 21, 2003); Southwestern Bell Telephone Company, FCC Tariff No. 73, Access Service, 3rd Revised Page 38-1, Section 38 (Effective Oct. 17, 2003).

117 Petition to Deny of CompTel, (*AT&T and BellSouth Corp. Application for Transfer of Control*) *WC* Docket No. 06-74 at 13-16 (filed Jun. 5, 2006).

demand, the incumbent can therefore condition the availability of discounts on certain circuits (the majority, for which no competitive alternative is available) on the customer's commitment to transfer the 'competitively sensitive' portion of its demand to the incumbent."[118] Because subscribers face high termination penalties when volume commitments are not reached, those costs are far greater than any saving recouped through cheaper special access services from non-ILEC providers.[119]

Since the initial filing of comments and reply comments in this proceeding, the mergers of Verizon and MCI, SBC and AT&T, and the "new" AT&T and BellSouth, have all resulted in the national market for special access services being dominated by two RBOCs: AT&T and Verizon. The duopoly that recently has emerged brings with it the danger of collusion between the "new" AT&T and Verizon. In prior merger review proceedings, the Commission determined that the risk of collusion is greatest where the number of ILECs is reduced and high market barriers exist.[120] Importantly, the Commission also determined that mergers resulting in duopoly (or monopoly) tend to harm the public interest, and therefore warrant strong presumptions of illegality under existing antitrust doctrines.[121] At bottom, the Commission must reconsider its regulation of special access pricing in light of the dramatically changed, post-merger market conditions.

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118 *Id.*

119 *Id.*

120 *Id.* at 14 (citing SBC/Ameritech Merger Order ¶ 104).

121 *Id.* at 16 (citing *Application of EchoStar Communications Corporation, General Motors Corporation and Hughes Electronics Corporation (Transferors) and EchoStar Communications Corporation (Transferee)*, Hearing Designation Order, 17 FCC Rcd 20559 ¶ 103 (2002).

B. Decreased Availability of UNEs Leads to Increased Market Power in the Provision of Special Access

Section 251 of the 1996 Act obligates ILECs to unbundle loop and dedicated transport network elements, and to offer such network elements subject to the terms and conditions of state commission approved interconnection agreements, at cost-based rates.[122] Furthermore, Section 271 of the 1996 Act obligates the RBOCs to unbundle loop and dedicated transport network elements, and to offer such network elements at rates, and subject to terms that are just and reasonable.[123] Those high-capacity (DS1 and DS3 capacity) loop and dedicated transport network elements offered pursuant to Section 251 and, to a very limited extent, Section 271, enable CLECs to deploy economically facilities-based networks in competition with the ILECs. In contrast, special access circuits, because they are priced far above cost and contain onerous terms and conditions, are poor substitutes and inhibit facilities-based deployments.

Since the initiation of this proceeding, federal and state commission decisions impacting the ILECs' statutory unbundling obligations have resulted in growing limitations on access to Section 251 UNEs. Moreover, several state commissions, with few exceptions, have declined to enforce Section 271 unbundling obligations through the interconnection agreement arbitration process or otherwise. Those that have exercised Section 271 authority have largely been reversed by the federal courts. As a result, the rates, terms and conditions for Section 271 network elements in most states are simply those that apply to the RBOCs' month-to-month special access offerings.

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122 47 U.S.C. § 251(c)(3).

123 47 U.S.C. § 271(c)(2)(B)(ii).

1. High Capacity Loops and Dedicated Transport Facilities

Since the initial filing of comments and reply comments in this proceeding, carriers have, in large part, implemented the Commission's *TRRO* and numerous state commissions have issued decisions interpreting it. Per the *TRRO,* ILECs are no longer obligated to provide certain high-capacity (DS1 and DS3) loop and dedicated transport UNEs in wire centers or on routes that meet or exceed the non-impairment thresholds established by the Commission.[124] The initial transition period for high-capacity loop and dedicated transport UNEs deemed "non-impaired" by the ILECs on the effective date of the *TRRO* expired on March 11, 2006.[125] Those UNEs subject to the initial transition period, with rare exception, already have been converted or are slated to be converted to unreasonably priced special access services or, in rare instances, services provided over other competitive facilities.[126] Importantly, effective March 11, 2005, the ILECs also are no longer obligated to unbundle dedicated transport UNEs that do not connect ILEC wire centers (*i.e.,* entrance facilities).[127]

In combination, these new Commission rules ending access to UNEs have resulted in the loss of critical inputs by facilities-based competitors to ILECs, thereby increasing the incumbents' market power in the provision of special access services.***

V. THE COMMISSION SHOULD REVOKE PHASE II PRICING FLEXIBILITY, REINITIALIZE RATES, AND BAN THE USE OF EXCLUSIONARY OR ANTI-COMPETITIVE TERMS AND CONDITIONS

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124 47 C.F.R. §§ 51.319(a)(4)(i); 51.319(a)(5)(i); 51.319(e)(2)(ii)(A); 51.319(e)(2)(iii)(A).

125 47 C.F.R. §§ 51.319(a)(4)(iii); 51.319(a)(5)(iii); 51.319(e)(2)(ii)(C); 51.319(e)(2)(iii)(C).

126 Covad *Clancy Decl.* ¶ 6; XO *Koppersmith Decl.* ¶ 9.

127 47 C.F.R. § 51.319(e)(2)(i).

The existing special access pricing flexibility regime is fatally flawed, and there is no reason to believe that recent market and regulatory developments – namely, the industry consolidation over the last few years and the elimination of UNEs in certain areas – will result in special access prices being regulated by market forces. In fact, just the opposite is the case. As demonstrated herein, pricing flexibility has resulted in special access rates that are unjust, unreasonable, discriminatory, and not in the public interest. The Joint Commenters join other competitive carriers and users of special access services in emphasizing that a substantial overhaul of the Commission's current price cap and pricing flexibility regime is necessary to constrain the ILECs' ability to exercise their market power in the special access markets.[128]

There are two principal components to the reform proposed by the Joint Commenters. First, in view of the overwhelming evidence that ILECs remain dominant in the provision of special access services and have used their market power to constrain competition and harm consumers, the Commission should reinstate an effective system of price cap regulation that ensures that special access prices are set at just and reasonable levels. Second, the Commission should act to eliminate the exclusionary pricing practices of many of the ILECs, including term and volume commitments with excessive termination penalties, forced UNE/special access conversion, and non-advocacy requirements.[129]

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128 *See, e.g.*, Ad Hoc Comments, WC Docket No. 05-25, at 16-21 (filed June 13, 2005); ATX Comments, WC Docket No. 05-25, at 5-10 (filed June 13, 2005); Ionary Comments, WC Docket No. 25-25, at 1-3 (filed June 13, 2005); PAETEC Comments, WC Docket No. 05-25, at 4-5 (filed June 13, 2005); Nextel Reply Comments, WC Docket No. 05-25, at 14-28 (filed Jul. 29, 2005).

129 Joint Commenters oppose Nextel's proposal to replace collocation triggers with *TRRO* non-impairment standards. *See* Nextel Reply Comments, WC Docket No. 05-25, at 32-34 (filed July 29, 2005). As demonstrated herein, these standards

In enacting the first component of the remedy proposed by Joint Commenters, the Commission should begin by reinitializing ILEC tariffed special access price caps at an 11.25% rate of return. The Commission should also adopt an X-factor, which would require the ILECs to reduce their rates by a certain percentage each year, thereby requiring the ILECs to share their productivity gains with their customers. More specifically, the Commission should adopt, at least on an interim basis subject to further review, a 5.3% X-factor in order to ensure that the ILECs' special access rates are established at reasonable levels.[130] Indeed, some commenters have felt that an 11.25% rate of return and a 5.3% X-factor is overly generous toward the ILECs.[131]

Additionally, once existing rate levels for special access have been reinitialized and the X-factor set, the Commission could grant downward pricing flexibility across all access markets. Downward pricing flexibility would allow the ILECs to reduce prices in response to competition and provide a self-executing regulatory device that should automatically assure the appropriate regulatory treatment of ILEC rates.[132] Since market forces would work to restrain ILECs from raising prices where sufficient competition is present, they have no legitimate need for pricing flexibility in the upward direction.

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have resulted in the elimination of UNEs despite the absence of economic competitive or self-supply options. XO *Govil Decl.* ¶ 31-34; Covad *Clancy Decl.* ¶ 10-13.

130 Nextel Reply Comments, WC Docket No. 05-25 (filed July 29, 2005).

131 *See, e.g.*, Ad Hoc Telecommunications Users Committee Comments, WC Docket No. 05-25, at 37-38 (filed July 13, 2005) ("the 11.25% return level is likely an extremely generous mark given current market conditions and can in no way be viewed as confiscatory, or even disadvantageous, for the ILECs.").

132 *See e.g., Competition in Access Markets: Reality or Illusion, A Proposal for Regulation Uncertain Markets Prepared for the Ad Hoc Telecommunications Users Committee,* August 2004 at 12 ("*ETI White Paper*"), attached to the Ex Parte Letter from Colleen Boothby, Counsel for Ad Hoc Telecommunications Users Committee, to Marlene H. Dortch, FCC, WC Docket No. 04-313 (filed Sep. 30, 2004).

With respect to the second component of the relief proposed by the Joint Commenters, the elimination of exclusionary and anti-competitive terms and conditions would do much to help ensure an open and fair marketplace for special access services. Currently, numerous ILECs tie special access pricing to very high term and volume commitments with excessive termination penalties. Such preferences can unfairly favor larger service providers over smaller service providers and, in so doing, can stifle competition. Similarly, the Commission should forbid the ILECs from entering into contracts that require a service provider to convert all or a percentage of its UNEs to special access services, to guarantee a certain percentage of "spend" on special access, or to agree only to purchase special access services in the future. Finally, the ILECs' new trend toward presenting discounted offerings to customers who agree not to oppose ILEC interests in Commission proceedings is not only anti-competitive, it is contrary to public policy. In order to reach proper results in its proceedings, the Commission must ensure that all interested parties are free to participate fully and in an unencumbered manner. Attempts to limit this right are essentially efforts to undermine the Commission and the effectiveness and legitimacy of its decision making process.

Notably, to ensure that the relief enacted in this docket is meaningful, the Commission should adopt a "fresh look" policy for all special access agreements currently in force.[133] A fresh look policy would give special access customers an opportunity to terminate current arrangements for a set period of time after the effective date of a Commission order in this proceeding. During this time, the terms of these contracts could be renegotiated to comply with the new rules governing the maximum

133 *See, e.g., Expanded Interconnection with Local Telephone Company Facilities, Second Memorandum Opinion and Order on Reconsideration*, 8 FCC Rcd 7341 (1993).